COMMERCIAL REAL ESTATE OUTLOOK

FEBRUARY 2010

ECONOMIC OVERVIEW

Commercial Real Estate Faces Another Difficult Year

By George Ratiu, NAR Economist

The economy closed the book on 2009 with an upbeat chapter. Economic activity continued its growth pattern in the fourth quarter, with major indicators posting positive results. Gross domestic product was positive for the second consecutive quarter, industrial production continued its advance and manufacturing employment posted a slight increase.

At the same time, commercial real estate concluded the year with mixed results. Fundamentals remained weak, investments were down and the volume of distressed properties increased. Contracting credit and a tightened lending environment added to the pressure. However, there are signs that the market is nearing the end of the decline in 2010, with improvement expected for 2011.

Economic Activity

Building on the third quarter's advance, gross domestic product (GDP) rose 5.7% in the fourth quarter of 2009. All GDP components except government spending posted positive figures. Consumers maintained a cautious approach to spending, pushing personal consumption expenditures up 2.0%. While spending on durable goods was down 0.9%, most of it was due to a 22.3% drop in spending on motor vehicles and parts. The furnishings and household equipment component was up 9.6%, while recreational goods and vehicles gained 15.1%. Meanwhile, spending on nondurable goods was also a positive 4.3%, helped in large part by spending on food and beverages (up 4.2%) and clothing and shoes (up 7.8%).

Optimism in the broader economic recovery was illustrated in the level of business investments. For the fourth quarter, investments jumped a significant 39.3%. The advance was underpinned by large expenditures on business equipment, software and transportation and related equipment. In particular, spending on computers and peripheral equipment shot up 82.8%. Transportation equipment investments also posted significant gains—up 75.8% from the third quarter. Business spending on commercial structures continued on a downward path, declining 15.4% in the fourth quarter, the sixth consecutive quarterly drop.

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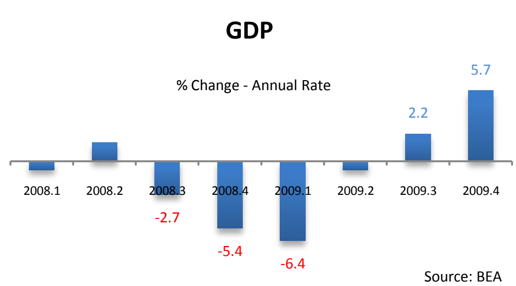

NAR FORECAST:

Commercial real estate will likely lag the economic recovery. Fundamentals are expected to continue the trend of negative absorption, rising vacancies and declining rents. Rising distress and maturing debt will pose serious challenges to commercial sectors.

Market Fundamentals

2009.Q4 / 2010.Q1

OFFICE

- ↑ Vacancy
- ↓ Net Absorption
- ↓ Completions
- ↓ Rent Growth

INDUSTRIAL

- ↑ Vacancy
- ↓ Net Absorption
- ↓ Completions
- ↓ Rent Growth

RETAIL

- ↑ Vacancy
- ↓ Net Absorption
- ↓ Completions
- ↑ Rent Growth

MULTIFAMILY

- ↓ Vacancy
- ↑ Net Absorption
- ↓ Completions
- ↔ Rent Growth

ECONOMIC OVERVIEW

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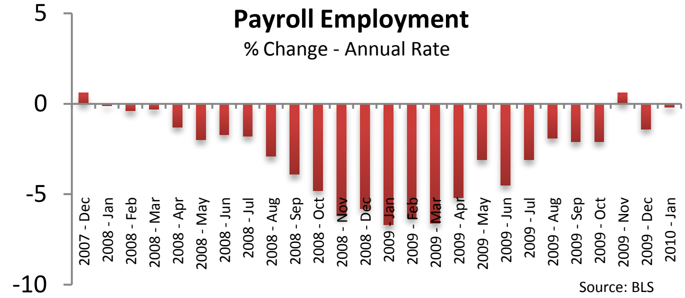
The other contributor to GDP growth was the positive shift in net exports. For the fourth quarter, exports grew at a faster pace than imports—18.1% versus 10.5%, respectively. The continued low value of the dollar drove the exports of goods, which increased 28.1%.

Government spending was down 0.2% for the quarter, mostly due to cuts in spending at the state and local levels. Federal government spending was virtually unchanged, posting a slight 0.1% rise. State and local government spending declined 0.3%.

The economic stabilization and the move toward growth are mirrored in multiple indices. The Federal Reserve Bank of Chicago tracks 85 indicators of economic activity, which it combines in its national activity index—an index value greater than zero points to growth in the pace of economic activity. In January 2010, the index moved up to a value of 0.02 from negative 0.58 in December 2009. The main drivers for the index's rise came from growth in production indicators.

However, while expectations for continued economic growth solidify, the stubborn level of unemployment dampens the outlook for 2010. Except for a solitary 0.6% rise in November 2009, payroll employment has been declining for two years. Over this period, 8.4 million jobs have been cut, leading many job seekers into longer job searches, and causing others to discontinue their attempts altogether. The number of people receiving unemployment benefits has been hovering around the 4.5 million mark. The unemployment rate jumped from 5.0% in December 2007 to 10.0 in December 2009.

The silver lining—albeit a rather thin one—in the employment situation has been that the rate of employment cuts has been declining and there are modest signs of improvement. Based on gains in industrial production and manufacturing, employers are showing renewed interest in making new hires. Payroll employment in manufacturing rose 1.2% in January 2010, the first positive figure since January 2007.



Mining and logging also posted a positive 7.3% rate of growth. In addition, professional and business services employment increased by 3.3% in January 2010, buoyed by a 13.0% advance in accounting positions.

Nonetheless, there are large sectors of the economy that are still facing an uphill struggle. Employment in the construction sector fell 14.7% in January, while transportation and warehousing employment declined 5.4%. Other sectors also posted employment losses in January—finance and insurance dropped 2.7%, real estate and leasing was down 1.6%, while leisure and hospitality declined 1.3%.

Commercial Real Estate

Based on the employment figures and the broader economic activity, commercial real estate is still battling with weak fundamentals and modest investment activity. Yet, there are signs that the decline in commercial markets may be nearing a bottom, with indicators pointing towards some modest improvement towards the end of 2010 and into 2011. Due to continued low demand, vacancy rates are expected to rise and remain elevated for most property types. In turn, rental rates will continue declining.

For the first quarter 2010, net absorption is expected to decline 13.1 million square feet for office space and 47.7 million square feet for industrial properties. Retail space is likely to record 2.0 million square feet of negative net absorption. Available space continues to grow across these property types.

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ECONOMIC OVERVIEW

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Vacancy rates for the first quarter are expected to hit 16.9% for office properties, 14.3% for the industrial sector, and 12.6% for retail. Tenant concessions, including free rent are the current standard in negotiations. Rental rates are expected to decline for 2010—7.2% for office space, 9.6% for industrial and 2.4% for retail properties.

The multifamily sector is poised to fare better, with a positive quarterly net absorption of 18.5 thousand units in net absorption, matched by a slight decrease in the vacancy rate from 7.4% in the fourth quarter 2009 to 7.3% in the first quarter 2010. However, rental rates for apartments continue to experience downward pressures. They are expected to decline 3.4% over 2010.

On the investment and transaction side, commercial real estate closed the year with weak performance figures. At a total of $52 billion, sales declined 64% in 2009 from 2008. Compared with the peak sales of 2007, sales were down 90% last year. The number of properties sold was also down 60%, to just 3,336. Meanwhile, property prices declined across all property types, pushing cap rates up 85 basis points in 2009.

There were a few positives in the battered landscape. Quarterly sales volume increased steadily from $10 billion in the first quarter to $18 billion in the fourth. The apartment and retail sectors recorded positive year-over-year sales in the fourth quarter. The commercial mortgage-backed securities (CMBS) market posted the first new issuance in the fourth quarter. In addition, deal sizes increased through the year, and the fourth quarter also managed to see portfolio transactions.

Yet, lending continued to pose the main challenge to investments in commercial real estate. The volume of distressed properties expanded, approaching $200 billion by the end of the year.

During 2009, loan balances at commercial banks steadily declined, with lending for construction, development and commercial loans posting large drops. In an effort to strengthen their balance sheets, banks increased their holdings of conservative assets.

All of which leads to the question—how are commercial properties likely to fare in 2010 and 2011 considering the high level of maturing debt?

The answer is not as precise or as clear as one would like. It is obvious that there will continue to be properties which will default and go bankrupt this year. However, given the magnitude of the refinancing situation, the Federal Reserve issued a policy statement on Prudent Commercial Real Estate Loan Workouts, aimed at encouraging loan extensions and modifications. While that will not provide a permanent solution, it will likely blunt the impact that the high volume of maturing loans will have in 2010.

Looking ahead, commercial real estate is still facing a tumultuous year. Market fundamentals will continue to be weak, keeping downward pressure on asset prices. However, a broader economic stabilization should provide a stronger foundation for financial recovery. Employment remains the major factor in the economic equation. Without sustained job creation, any economic recovery will be muted, prolonging the difficulties faced by commercial real estate.

NCREIF PROPERTY INDEX RETURNS – 2009.Q4

NATIONAL	-2.11%
OFFICE	-2.75%
INDUSTRIAL	-2.59%
RETAIL	-0.92%
APARTMENT	-1.81%

Source: National Council of Real Estate Investment Fiduciaries

ECONOMIC FORECAST

Annual Growth Rates (%)	2009 I	2009 II	2009 III	2009 IV	2010 I	2010 II	2010 IIII	2010 IV	2011 I	2011 II	2009	2010	2011
Real GDP	-6.4	-0.7	2.2	5.7	2.2	2.1	2.5	3.2	3.3	3.7	-2.4	2.8	3.2
Nonfarm Payroll Employment	-5.9	-4.5	-2.6	-1.4	1.2	1.3	1.4	1.5	1.7	2.4	-3.7	-0.1	1.7
Consumer Prices	-2.4	1.3	3.6	2.0	1.3	1.3	1.7	1.2	2.2	3.0	-0.4	1.8	2.3
Real Disposable Income	0.2	6.2	-1.4	-3.8	2.1	2.4	0.2	2.5	6.4	4.2	0.9	0.6	3.4
Consumer Confidence	30	48	52	51	55	55	56	60	62	65	45	57	65
Unemployment (%)	8.1	9.2	9.3	10.1	10.2	10.0	10.0	9.9	9.9	9.7	9.3	10.0	9.7

Interest Rates (%)	2008 III	2008 IV	2009 I	2009 II	2009 III	2009 IV	2010 I	2010 II	2010 IIII	2010 IV	2009	2010	2011
Fed Funds Rate	0.2	0.2	0.2	0.2	0.2	0.2	0.5	1.0	1.8	2.2	0.2	0.5	2.3
3-Month T-Bill Rate	0.2	0.2	0.2	0.2	0.2	0.2	0.5	1.0	1.7	2.1	0.2	0.5	2.2
Prime Rate	3.3	3.3	3.3	3.2	3.3	3.3	3.4	3.8	4.5	5.0	3.2	3.5	5.3
Corporate Aaa Bond Yield	5.3	5.5	5.3	5.2	5.3	5.2	5.3	5.4	5.6	5.8	5.3	5.3	5.9
10-Year Government Bond	2.7	3.3	3.5	3.5	3.7	3.7	3.9	4.0	4.2	4.4	3.3	3.8	4.5
30-Year Government Bond	3.5	4.2	4.3	4.1	4.2	4.3	4.4	4.6	4.8	5.0	4.0	4.4	5.0

Source: National Association of REALTORS®

COMMERCIAL FORECAST

OFFICE	2009 II	2009 III	2009 IV	2010 I	2010 II	2010 III	2010 IV	2009	2010	2011
Vacancy Rate	15.5%	16.1%	16.3%	16.9%	17.3%	17.5%	17.6%	15.7%	17.3%	17.4%
Net Absorption ('000 sq. ft.)	-15,668	-5,243	-216	-13,136	-8,344	-3,672	-2,099	-38,106	-27,251	24,685
Completions ('000 sq. ft.)	15,040	16,393	10,854	9,688	6,925	3,224	2,389	52,787	22,226	7,083
Inventory ('000,000 sq. ft.)	3,547	3,562	3,572	3,582	3,589	3,592	3,594	3,572	3,594	3,602
Rent Growth	-6.3%	-0.9%	-1.2%	-2.2%	-1.8%	-1.8%	-1.4%	-12.7%	-7.2%	-4.5%

INDUSTRIAL	2009 II	2009 III	2009 IV	2010 I	2010 II	2010 III	2010 IV	2009	2010	2011
Vacancy Rate	13.0%	13.5%	13.9%	14.3%	14.6%	14.8%	14.9%	13.2%	14.6%	14.5%
Net Absorption ('000 sq. ft.)	-80,296	-53,647	-38,103	-47,716	-30,558	-14,975	-254	-258,071	-93,503	134,183
Completions ('000 sq. ft.)	16,151	14,841	14,761	12,300	5,854	8,244	10,955	70,082	37,353	44,855
Inventory ('000,000 sq. ft.)	12,963	13,007	13,110	13,123	13,128	13,137	13,148	13,110	13,148	13,193
Rent Growth	-2.6%	-1.8%	-2.2%	-2.5%	-2.4%	-2.4%	-2.4%	-10.9%	-9.6%	-7.9%

RETAIL	2009 II	2009 III	2009 IV	2010 I	2010 II	2010 III	2010 IV	2009	2010	2011
Vacancy Rate	11.7%	12.2%	12.4%	12.6%	12.7%	12.7%	12.7%	12.0%	12.7%	12.7%
Net Absorption ('000 sq. ft.)	-5,456	-1,253	-667	-1,998	-1,059	-456	136	-18,325	-3,377	8,810
Completions ('000 sq. ft.)	3,025	3,503	2,778	1,267	866	203	179	12,034	2,515	7,182
Inventory ('000,000 sq. ft.)	1,653	1,656	1,659	1,660	1,661	1,661	1,661	1,659	1,661	1,673
Rent Growth	-0.5%	0.0%	-1.2%	-0.9%	-0.6%	-0.6%	-0.3%	-4.0%	-2.4%	-0.1%

MULTI-FAMILY	2009 II	2009 III	2009 IV	2010 I	2010 II	2010 III	2010 IV	2009	2010	2011
Vacancy Rate	7.4%	7.3%	7.4%	7.3%	6.9%	6.4%	6.6%	7.4%	7.0%	6.1%
Net Absorption (Units)	37,535	58,362	12,501	18,543	60,700	69,371	-33,622	105,458	114,992	173,272
Completions (Units)	55,638	40,032	29,578	20,917	15,156	12,249	10,994	177,589	59,316	53,328
Inventory (Units in millions)	14.3	14.4	14.4	14.4	14.4	14.5	14.5	14.4	14.5	14.5
Rent Growth	-1.2%	-1.3%	-1.0%	-1.0%	-0.9%	-0.8%	-0.7%	-3.6%	-3.4%	0.2%

Source: National Association of REALTORS®/CBRE-Econometric Advisors

COMMERCIAL FORECAST: METRO VACANCY RATES - 2010.Q1

	Office	Industrial	Retail	Multifamily
Albuquerque, NM	19.5%	14.8%	10.6%	6.6%
Atlanta, GA	21.6%	18.3%	16.0%	10.5%
Austin, TX	20.0%	15.7%	11.3%	8.7%
Baltimore, MD	16.3%	16.1%	11.1%	6.7%
Boston, MA	13.7%	18.7%	10.0%	5.2%
Charlotte, NC	18.0%	16.2%	12.8%	8.8%
Chicago, IL	19.1%	15.6%	13.8%	6.8%
Cincinnati, OH	17.3%	12.4%	17.7%	9.4%
Cleveland, OH	16.4%	11.6%	16.7%	8.1%
Columbus, OH	17.4%	16.5%	17.9%	7.6%
Dallas, TX	22.3%	16.5%	16.4%	10.0%
Denver, CO	17.7%	13.3%	12.9%	6.9%
Detroit, MI	24.6%	20.7%	18.1%	8.1%
Fort Lauderdale, FL	19.7%	11.8%	12.2%	5.7%
Fort Worth, TX	14.9%	15.5%	16.5%	10.3%
Hartford, CT	17.9%	14.6%	-	-
Honolulu, HI	9.2%	-	7.5%	7.8%
Houston, TX	16.5%	10.7%	13.2%	11.0%
Indianapolis, IN	16.9%	12.8%	19.0%	9.7%
Jacksonville, FL	22.6%	15.7%	13.9%	12.3%
Kansas City, MO	17.4%	9.9%	15.5%	8.6%
Las Vegas, NV	23.1%	12.2%	14.9%	10.0%
Long Island, NY	11.3%	10.7%	8.3%	-
Los Angeles, CA	16.6%	8.6%	8.5%	6.4%
Miami, FL	22.0%	13.2%	8.5%	5.9%
Minneapolis, MN	20.3%	12.1%	12.7%	6.7%
Nashville, TN	15.1%	12.6%	13.8%	7.2%
New York, NY	8.4%	12.1%	11.1%	6.2%
Northern New Jersey (Newark)	15.4%	13.0%	-	5.0%
Oakland, CA	16.8%	15.3%	10.0%	5.5%
Orange County, CA	20.8%	11.7%	7.6%	5.4%
Orlando, FL	18.7%	15.8%	12.8%	9.0%
Philadelphia, PA	14.9%	14.2%	12.8%	7.0%

COMMERCIAL FORECAST: METRO VACANCY RATES - 2010.Q1

	Office	Industrial	Retail	Multifamily
Phoenix, AZ	26.4%	19.5%	14.4%	11.3%
Pittsburgh, PA	11.5%	-	-	4.6%
Portland, OR	17.3%	11.2%	11.0%	6.3%
Raleigh, NC	16.1%	-	-	6.9%
Riverside, CA	23.4%	16.1%	13.8%	8.3%
Sacramento, CA	21.1%	16.8%	14.8%	6.8%
Salt Lake City, UT	17.7%	11.2%	13.2%	8.3%
San Diego, CA	20.1%	15.3%	9.6%	5.4%
San Francisco, CA	14.5%	10.7%	6.6%	5.9%
San Jose, CA	25.7%	15.5%	7.8%	3.3%
Seattle, WA	17.7%	11.5%	11.1%	5.7%
St. Louis, MO	15.1%	15.6%	13.3%	9.0%
Stamford, CT	10.9%	17.9%	-	-
Tampa, FL	24.0%	14.2%	12.0%	8.8%
Tucson, AZ	17.6%	12.6%	16.4%	9.3%
Ventura, CA	17.1%	13.0%	9.9%	-
Washington, DC	14.1%	15.6%	10.5%	4.9%
West Palm Beach, FL	23.2%	14.8%	12.1%	6.8%
Wilmington	19.6%	17.0%	15.3%	-
National Averages*	**16.9%**	**14.3%**	**12.6%**	**7.3%**

N.B. *Not all markets are represented in chart above.

Source: National Association of REALTORS® / CBRE-Econometric Advisors

SIOR COMMERCIAL REAL ESTATE INDEX

FOURTH QUARTER 2009 RESULTS

January 2010 – More than 700 SIOR market experts across the country weighed in on local Industrial and Office market conditions for the Fourth Quarter 2009 SIOR Commercial Real Estate Index, compiled by the SOCIETY OF INDUSTRIAL AND OFFICE REALTORS (SIOR) in association with the NATIONAL ASSOCIATION OF REALTORS (NAR). SIOR members again report that the national economic recession continues to have a significant negative affect on local industrial and office markets. However, 55% of SIOR members expect the market to improve next quarter. Although only an 8% positive increase over the 3rd quarter sentiment, optimism, none the less, continues to increase.

Investment activity continues to be down across the board as 86% of SIOR experts report prices are below replacement cost—only 12% of respondents report prices in line with replacement costs.

Development activity continues to evaporate across the country as 98% of SIORs reported that development was down, with 87% saying that development is virtually nonexistent in their markets. SIORs overall report a buyer's market for development sites—48% indicated a strong buyer's market while 49% indicated they were experiencing a buyer's market, but prices were stable.

Tenants continue to reap a benefit of today's economy as 97% of SIOR respondents report either deep discounts to asking rents or moderate levels of tenant concessions. Only 3% of SIORs feel they are experiencing a normal negotiating balance. Leasing activity continues to be below historic levels, vacancy rates remain high, and asking rents are low.

The SIOR Index, which measures 10 variables pertinent to the performance of U.S. industrial and office markets (see Methodology), rose slightly following 11 quarters of straight decline. It gained a miniscule .2% finishing at 35.5 points—100 points signifies a balanced market. We have not experienced equilibrium (100 points) since third quarter 2007.

Office Market

The national economy clearly is taking its toll on both the Industrial and Office markets. Leasing activity and rental rates for the Office market are slightly stronger than the Industrial market. However the Office market has more sublease space available and their prospects for improvement in the next three months are lower than the industrial market.

Industrial Market

Overall, the 4th quarter Industrial market points remained the same as 3rd quarter. However, it experienced a slightly higher increase in vacancy rates, higher levels of tenant concessions, and falling prices.

Regional Breakdown

The **West** (27.1 points) continues to be in the doldrums. Its overall market is suffering from the lowest level of leasing activity of all regions, the largest decline in asking rents, and the deepest level of concessions. Consequently, the short term outlook for the West is the lowest of all regions.

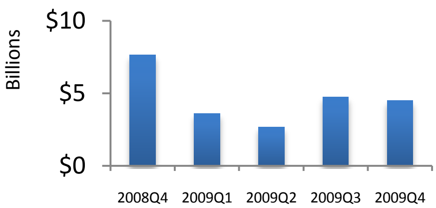
The **South** (37.8 points) has the highest performing submarket—the West South Central—which scored 44.7 points. The region posted the best vacancy rates of the four regions. While it is a buyer market in all regions, the South is experiencing prices that are slightly more stable.

The **Northeast** (43.7 points) Although declining 2.4 points from 3rd quarter 2009, the Northeast continues to led all regions scoring the highest total points this quarter. The region is finding prices that are slightly more stable, the amount of sublease space subsiding, and a slightly better level of development and leasing activity than other regions.

The **Mid-West** (36.3 points) did not change from 3rd quarter. Although the national economy is still having a negative affect in all markets, it is hitting the Mid-West more than other regions.

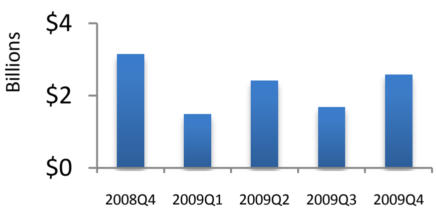
INVESTMENT TRENDS AT A GLANCE

Office Sales Volume



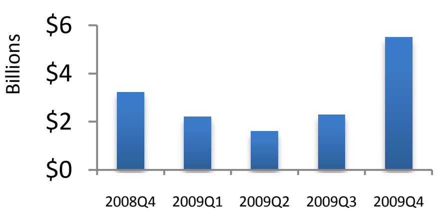
OFFICE		
Region	Average Cap Rate	Average Price ($/Sq. Ft.)
Mid-Atlantic	8.0%	$250
Midwest	8.5%	$149
Northeast	8.3%	$329
Southeast	8.2%	$178
Southwest	8.5%	$132
West	8.5%	$251

Industrial Sales Volume



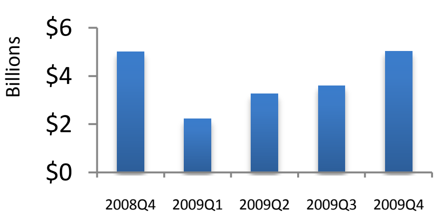
INDUSTRIAL		
Region	Average Cap Rate	Average Price ($/Sq. Ft.)
Mid-Atlantic	8.1%	$87
Midwest	9.0%	$53
Northeast	9.4%	$189
Southeast	8.1%	$70
Southwest	9.0%	$85
West	8.2%	$121

Retail Sales Volume



RETAIL		
Region	Average Cap Rate	Average Price ($/Sq. Ft.)
Mid-Atlantic	7.9%	$200
Midwest	7.6%	$204
Northeast	7.4%	$474
Southeast	8.2%	$188
Southwest	8.3%	$194
West	7.4%	$300

Multifamily Sales Volume



MULTI-FAMILY		
Region	Average Cap Rate	Average Price ($/Unit)
Mid-Atlantic	7.6%	$110,839
Midwest	7.3%	$61,780
Northeast	6.7%	$179,821
Southeast	7.6%	$79,116
Southwest	7.7%	$65,236
West	6.7%	$149,018

Note: Data based on sales closed in 2009
Source: Real Capital Analytics, January 2010

REALTOR® RESEARCH

The Research Division of the National Association of REALTORS® monitors and analyzes monthly and quarterly economic indicators, including retail sales, industrial production, producer price index, gross domestic product and employment data that clearly impact commercial markets over time. In addition, the Research Division provides several products covering commercial real estate:

- Commercial Member Profile
- Commercial Real Estate Quarterly Market Survey
- Commercial Real Estate Leading Indicator

For more information, please visit us at www.realtors.org/research. If you have questions or comments regarding this report or any other commercial real estate research, please contact George Ratiu, NAR Economist, at gratiu@realtors.org.

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